Discretionary Clauses

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What is a Discretionary Clause?

"Reservation of discretion clause" means language in a form that purports to reserve discretion to interpret the terms of the contract, to determine eligibility for benefits under the plan, or to establish a scope of judicial review or standards of interpretation, to the plan administrator, the insurance company acting in the capacity of a plan administrator in an employee benefit plan, or the insurance company acting as the insurer.

Utah Adminstrative Code Rule R590-218-4(5)

Discretionary Clauses in Use

"Benefits under this Plan will be paid only if the Plan Administrator or its designee (including the Insurer), decides in its discretion that the applicant is entitled to them."

"...the Company has sole authority to manage this Policy, to administer claims, to interpret Policy provisions, and to resolve questions arising under this Policy. . . Any decision the Company makes in the exercise of its authority shall be conclusive and binding."

Concerns With Discretionary Clauses

Discretionary Clauses:

- Alter the way courts review coverage disputes
- Were found to be unfair, deceptive and inequitable (Utah Insurance Department Bulletin 2002-7)
- Insurers claim discretionary clauses control costs

Discretionary Clauses Alter the Way Courts Review Coverage Disputes

When an insurance contract includes a discretionary authority provision, a court will apply an "*arbitrary and capricious*" standard of review, depriving a claimant a "*de novo*" standard of review.

Arbitrary and capricious standard of review:

The policyholder must prove that the decision is unreasonable, and not merely incorrect. The arbitrary and capricious standard is the least demanding form of judicial review...questions of judgment are left to the insurer or their administrator.

De novo standard of review:

A court must itself review the evidence that was before the administrator to determine whether it agrees with the administrator's conclusion. The court may be able to consider facts that were not known to the administrator when it made its decision. If after such a review the court determines it would have come to a different conclusion than the administrator, even if the decision of the administrator was reasonable, the court will substitute its judgment for that of the administrator.

Use of Discretionary Clauses in the Marketplace

24 states have acted to prohibit the use of discretionary clauses

"Discretionary clauses are inequitable, misleading, deceptive, obscure, unfair, not in the public interest, and otherwise contrary to law."

- Previous Utah Insurance Commissioner Merwin Stewart

Use of Discretionary Clauses in the Marketplace

The National Association of Insurance Commissioners (NAIC), a standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories, adopted a model that banned discretionary clauses in health insurance policies in 2002 and disability insurance policies in 2004.

These bans were intended to "assure that health and disability benefits are contractually guaranteed, and to avoid the conflict of interest that occurs when the health carrier has discretionary authority to decide what benefits are due."

- NAIC Health Insurance & Managed Care Comm.

Use of Discretionary Clauses in the Marketplace

The Interstate Insurance Product Regulation Commission whose membership includes 41 states and territories, including Utah, prohibits the use of discretionary authority provisions stating:

No policy or certificate may contain a provision:

(a) purporting to reserve sole discretion to the insurance company to interpret the terms of a policy or certificate; or

(b) specifying a standard of review upon which a court may review denial of a claim or any other decision made by an insurance company with respect to a Certificateholder.

Utah Insurance Department Actions

- Bulletin 2002-7, published July 29th, 2002, prohibits discretionary clauses in all accident and health, life and annuity contracts finding them to be inequitable, unfair, misleading, deceptive, obscure encourage misrepresentation and not in the publics' interest.
- Rule R590-218, effective March 21, 2003, continues the prohibition of discretionary clauses except for ERISA plans when the contract in the language is substantially similar to the language provided in the rule.

> "Benefits under this plan will be paid only if (the plan administrator) decides in its discretion that (the claimant) is entitled to them. (The plan administrator) also has discretion to determine eligibility for benefits and to interpret the terms and conditions of the benefit plan. Determinations made by (the plan administrator) pursuant to this reservation of discretion do not prohibit or prevent a claimant from seeking judicial review in federal court of (the plan administrator's) determinations.
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> The reservation of discretion made under this provision only establishes the scope of review that a federal court will apply when (a claimant) seeks judicial review of (the plan administrator's) determination of eligibility for benefits, the payment of benefits, or interpretation of the terms and conditions applicable to the benefit plan.
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> (The plan administrator) is an insurance company that provides insurance to this benefit plan and the federal court will determine the level of discretion that it will accord (the plan administrator's) determinations."

Does ERISA Preemption Apply?

Through ERISA's savings clause, §514(b)(2)(A), states are free to determine the contents of insurance contracts.

- The Supreme Court "has repeatedly held that state laws mandating insurance contract terms are saved from preemption." Unum v. Ward, 526 U.S. 358, 375-376 (1999), citing Metropolitan Life Ins. Co. v. Massachusetts 471 U.S. 724, 758 (1985).
- The Supreme Court has acknowledged that states indirectly regulate ERISA plans through the regulation of the plan's insurer and the plan's insurer's insurance contracts. FMC Corp. v. Holliday, 498 U.S. 52, 64 (1990).
- In Rush Prudential HMO, Inc. v. Moran, 122 S. Ct. 2151 (2002), the Supreme Court stated, "Nothing in ERISA, however, requires that these kinds of decisions be so 'discretionary' in the first place; whether they are is simply a matter of plan design or the drafting of an [insurance] contract."

Where Are We Now?

- The Tenth Circuit Court of Appeals in Hancock v. Metropolitan Life (2009), found that Rule 590-218 was expressly preempted by ERISA because the rule did not remove the option of insurer discretion from the scope of permissible insurance bargains in ERISA plans. The court also stated, "If Rule 590-218 imposed a blanket prohibition on the use of discretion granting clauses, we would have a different case."